NOTES

WASHINGTON NOTES

THE NEW BOND ISSUE

The greatest borrowing measure of American history has been passed by the Senate and House of Representatives, by the former under date of April 14 and by the latter under date of April 17 (H.R. 2762, Sixty-fifth Congress, first session). This measure authorizes the Secretary of the Treasury to borrow sums not exceeding in the aggregate $5,000,000,000 (besides other issues for special purposes, adding in the aggregate a considerable amount to the round sum thus provided for). The bonds are to be $3\frac{1}{2}$ per cent securities and are to be free of taxation except estate or inheritance taxes or taxes levied by state or local taxing authorities, and they are not to bear the privilege of serving as a basis for currency. Of the sum thus authorized, $3,000,000,000 is to be advanced for the purpose of aiding in the support of foreign-government credit, the bonds of such foreign governments being converted into American securities, so that the United States becomes a large holder of foreign issues at the same time that the proceeds of its own sales are used for the purchase of commodities needed by the allied governments in the war. It is generally admitted that to float so great a loan in the United States will require the use of practically all of the machinery for the issue and distribution of bonds available throughout the country, and consequently a lapse of some little time is to be expected before the bonds can be definitively placed on the market and sold to investors. Announcement is made that the effort of the government will be to see the bonds taken up by ultimate holders rather than by banks, in order that the resources of the banks may be kept as liquid as possible. As a preliminary measure for the relief of the Treasury, $50,000,000 of short-term 2 per cent certificates have already been sold to federal reserve banks, and about $250,000,000 of $2\frac{1}{2}$ per cent certificates have been subscribed for by commercial banks throughout the country. This $250,000,000 serves in part as a mere anticipation of the income-tax receipts expected at the end of June next, and in part as a preliminary payment on the great loan provided for in the act to which reference has already been made. It is understood that the certificates of indebtedness thus issued may be used as subsequent payment by subscribers for

the "war loan," thereby rendering the preliminary purchases convertible in one sense into long-term bonds. While the conditions under which the long-term bonds will be sold have not yet fully been made known, it is stated that they will probably run for five years, convertible at the end of that time into twenty- or thirty-year bonds at such rates of interest as conditions may then render possible. Many of the most important features of the loan are necessarily placed in the hands of the Secretary of the Treasury for determination, it being recognized that promptness of action and ability to negotiate as to terms will be essential to the entire success of the borrowing operation.

The floating of the new loan practically marks an epoch in American finance. Taken together with the new taxation which is now planned, it will probably nearly absorb the entire surplus production of the investable wealth of the nation during the next year. It thereby practically renders impossible the issue of other bonds in any considerable quantities, inasmuch as no market exists for other securities anywhere else in the world under prevailing conditions, while our own security-buying power is absorbed by the new issue of government bonds. Precisely what effect this issue will have upon general security prices cannot be positively forecast, not only because of the size of the operation, but also because on former occasions when transactions comparable to it were undertaken, either at home or abroad, there was always an outside market in which securities could be disposed of—a market which, as already noted, has now practically disappeared in consequence of the general condition of belligerency among the nations which have heretofore acted as providers of capital. The bond issue is also likely to be of very great significance in connection with the new program of taxation, which, if carried into effect, will in the case of the larger income-earners be likely to take up the surplus earnings above $3\frac{1}{2}$ per cent which are afforded by industrial and railway bonds. Should the taxation fall as heavily as this upon the larger holders of bonds, the result would apparently be to reduce the rate of interest to be derived from investments in bonds to about $3\frac{1}{2}$ per cent. What effect such a reduction would have upon the process of saving can as yet be only a matter of conjecture, but that the influence thus exerted will be important is beyond question.

NOTE-ISSUE POWER OF RESERVE BANKS

Considerable discussion has occurred within recent weeks with reference to the actual note-issue power of the federal reserve system. This is a more complicated matter than is appreciated by many, owing

STATEMENT INDICATING METHODS BY WHICH THE FEDERAL RESERVE BANKS MAY ATTAIN THE LARGEST POTENTIAL NOTE-ISSUE AND GOLD-LENDING POWER

	Total Note-issuing Power (in Thousands of Dollars)				Total Gold-lending Power (in Thousands of Dollars)				Note-issuing Power if All Gold Be Withdrawn from Agents (in Thousands of Dollars)	
	(1) Condition as of March 23, 1917	(2) Federal Reserve Notes and Eligible Paper on Hand Exchanged for Gold Held by Agent	(3) Issue $976,680,000 of Federal Reserve Notes against Paper Discounted or Bought	(4) If We Assume 5 Per Cent of Paper Must Be Out for Collection We Can Issue Only $908,540,000 of Notes	(5) Column (2)	(6) $249,807,000† of Paper Bought for Gold	(7) Eligible Paper Held by Bank Turned Over to Agent in Exchange for Gold	(8) $290,749,000† of Paper Bought for Gold	(9) Column (7)	(10) Issue $726,872,000 of Federal Reserve Notes against Paper Discounted or Bought
Resources—										
Reserve held	573,201	672,913	672,913	627,486	672,913	423,106	672,913	382,164	672,913	672,913
Collateral notes	3,391	3,391	3,391	3,391	3,391	3,391	3,391	3,391	3,391	3,391
Trade acceptances (not indorsed by member bank)	778	778	778	778	778	778	778	778	778	778
Paper with agent securing federal reserve notes issued	22,725	96,997	1,073,677	960,110*	96,997	96,997	346,804	346,804	346,804	1,073,676
Five per cent of all eligible paper in process of collection	5,105	5,105	5,105	50,532	5,105	5,105	5,105	5,105	5,105	5,105
Paper available as collateral for additional note issues	74,272	....	....	....	....	249,807	....	290,749	....	....
Federal reserve notes on hand	25,440	....	....	....	....	....	....	....	....	....
All other resources	7,361	13,361	13,361	13,361	13,361	13,361	13,361	13,361	13,361	13,361
Total	712,273	792,545	1,769,225	1,655,658	792,545	792,545	1,042,352	1,042,352	1,042,352	1,769,224
Liabilities—										
Government deposits	19,702	19,702	19,702	19,702	19,702	19,702	19,702	19,702	19,702	19,702
Member bank deposits, net	675,846	675,846	675,846	675,846	675,846	675,846	675,846	675,846	675,846	675,846
Federal reserve note liability	16,725	96,997	1,073,677	960,110	96,997	96,997	346,804	346,804	346,804	1,073,766
Total	712,273	792,545	1,769,225	1,655,658	792,545	792,545	1,042,352	1,042,352	1,042,352	1,769,224
Reserves required—										
Deposits: 35 per cent	243,442	243,442	243,442	243,442	243,442	243,442	243,442	243,442	243,442	243,442
Notes: 40 per cent	6,690	38,799	429,471	384,044	38,799	38,799	138,722	138,722	138,722	429,471
Total	250,132	282,241	672,913	627,486	282,241	282,241	382,164	382,164	382,164	672,913
Free gold	323,069	390,672	....	....	390,672	140,865	290,749	....	290,749	....
Agents' accounts—										
Gold	349,519	249,807	249,807	295,234	249,807	249,807	....	....	....	....
Paper (for collateral)	22,725	96,997	1,073,677	960,110	96,997	96,997	346,804	346,804	346,804	1,073,676
Total	372,244	346,804	1,323,484	1,255,344	346,804	346,804	346,804	346,804	346,804	1,073,676
Notes outstanding	372,244	346,804	1,323,484	1,255,344	346,804	346,804	346,804	346,804	346,804	1,073,676‡

* Only 95 per cent of the discounted paper is pledged with the agents, 5 per cent being in course of collection, this 5 per cent being taken out of the gold reserve and turned over to the agents.

† Total gold loaned on discounts or used to purchase eligible paper $249,807,000 plus $290,749,000=$540,556,000.

‡ Total note issue $1,073,676,000 plus gold loaned as per column (6) $249,807,000=$1,323,485,000 or maximum note issue as shown in column (3). It is thus seen that the federal reserve banks, by withdrawing the gold remaining with the agents, as shown by column (3) and paying it out in response to the demands of member banks, do not reduce their power of expansion.

to the fact that the holding of gold is divided between the federal reserve banks and the federal reserve agents, and that since the system was organized considerable amounts of federal reserve notes have been issued practically against gold, thereby creating a large fund of gold in the hands of federal reserve agents which could be withdrawn by substituting commercial paper should business at the banks become more active, and should their holdings of paper correspondingly increase. While estimates of the issue power of the banks have varied considerably owing to the lack of a uniform basis for computation, correct estimates show that they could put out today about $1,000,000,000 in federal reserve notes in addition to those already in circulation. The method of computation is of considerable interest as showing the working of the process by which such advances of notes take place. Inasmuch as very nearly $1,000,000,000 of notes has been printed and stored at the various mints and subtreasuries throughout the country, a considerable portion of the sum having already been so distributed, the question of rendering this note supply available is entirely in the hands of the member banks of the system, which, by presenting paper for rediscount, can at any time obtain the use of the paper currency thus made ready.

The table on p. 507 shows in extended form the details of the process of computing the note-issue power, as well as the gold-lending power of the banks, taken as a unit.